A PRiME perspective on economics curriculum design

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OPINION ARTICLE

A PRiME perspective on economics curriculum design [version 1; peer review: awaiting peer review]

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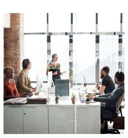
Abstract
The United Nations' Principles of Responsible Management Education initiative aspires to transform the relationship between business and society by ensuring that the next generation of business leaders are shaped by management education that conceptualises businesses as generators of sustainable value. Simplistic economic models overemphasize the role of narrow profit maximization on the part of firms in generating broader economic wellbeing. More nuanced views of the relationships between firms and the societies in which they operate, such as those that allow for market power in product and labour markets, for the presence of externalities in the production of goods and services, for a role of the state in the provision of public goods, and for the existence of market failures more generally, offer profoundly different advice to aspiring practitioners of responsible management. This article proposes an introductory economics curriculum for management students that gives due emphasis to these more nuanced perspectives and thus equips aspiring business leaders with the skills they will need to build profitable enterprises that also fulfil the objective of generating sustainable value as envisioned by the Principles of Responsible Management Education.

Keywords
Economics education, introductory economics, responsible management, management training.



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Any reports and responses or comments on the article can be found at the end of the article.

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Introduction

The U.N. supported Principles of Responsible Management Education (PRiME) initiative aspires to transform the relationship between business and society by ensuring that the next generation of business leaders are shaped by management education that conceptualises businesses as generators of sustainable value (UN Global Compact, 2007). This note argues that an economics curriculum designed in accordance with these principles can be a powerful tool to achieve this objective and proposes some key elements of such a curriculum.

Contemporary economics offers a wide range of perspectives on the interrelationships between business and society and thus on what constitutes responsible management in a specific context. The most simplistic of these perspectives implies that profit maximizing firms alone can deliver outcomes which maximize economic welfare. In this view, responsible management is reduced to the single-minded pursuit of profits. However, more nuanced views of the relationships between firms and the societies in which they operate, such as those that allow for monopoly power in product markets, monopsony power in labour markets, for the presence of externalities in the production of goods and services, for a role of the state in the provision of public goods, and for the existence of market failures more generally, offer profoundly different advice to aspiring practitioners of responsible management. Thus, a well-rounded management curriculum should give due emphasis to these more nuanced economic perspectives.

A common practice in the design of economics curricula is to present theory in layers of increasing complexity. However, a constraint that often faces economics educators on management degrees is that such degrees typically require students to engage with economics only at the introductory level, usually in large cohorts that include students on a variety of other degree programmes. In this context, a layered economics curriculum that is focused on the needs of specialist economics students, may do a disservice to students on other degree programmes as the narratives that emerge from the most simplistic economic models usually overemphasize the role of self-interest in generating value for society. Thus, a poorly designed introductory economics module can risk falling short of PRiME's objectives by failing to prepare aspiring practitioners of responsible management with an education that covers a diversity of views on the relationship between business and society.

This note offers a perspective on the design of an introductory economics curriculum that is tailored to addresses the foregoing concerns. Such a curriculum will of course celebrate the power of profit-seeking firms to generate growth and prosperity, a power that is characteristic of the modern global economy. But it will also make future business leaders aware of the numerous contexts in which an overly narrow focus on self-interest can impair a firm's ability to generate sustainable value for society. The next section reflects on how the principles of self-interest and profit maximization can be taught to foster responsible management practices. The note then goes on to discuss a number of specific economic models that can form the basis of a 15-credit introductory economics sequence that will equip aspiring business leaders with the skills they will need to build profitable enterprises that also fulfil the objective of generating sustainable value as envisioned by PRiME.

Narratives of self-interest and responsibility

The idea that narrow self-interest should motivate firms is not new. Intellectual curiosity around the sufficiency of self-interest in producing socially desirable outcomes goes back to the inception of the economic sciences. As is well known, in *An Inquiry into the Nature and Causes of the Wealth of Nations* Adam Smith observed that "It is not from the benevolence of the butcher, the brewer, or the baker that we expect our dinner but from their regard to their own interest," and "By pursuing his own interest he frequently promotes that of society more effectually than when it really intends to promote it" (Smith, 1776). These quotes are often included in introductory economics lectures to motivate the central insights of the theory of the perfectly competitive firm.

The perfectly competitive benchmark presents an elegant theoretical exposition in which profit maximization as the sole motivating force for firm behaviour is not only desirable, but socially optimal. Despite the alluring simplicity of this argument, economic theory circumscribes its relevance to a very narrow domain, i.e. where firms are small in relation to the market in which they operate, where products are homogenous, where there are no externalities or public goods and where the provision of information is perfect. Indeed, Smith himself was acutely aware of the potential for non-competitive outcomes to arise in practice[1]. Nonetheless, the narratives that emerge from this theory hold very broad – arguably too broad – influence in social, political, and business decision making and can undermine the effectiveness of management education that is designed to nurture responsible business practices.

There are several steps that educators can take to counteract these forces. The perfectly competitive model should be presented as one abstract craterisation of firm behaviour, among many others. Attention should be drawn to the extreme nature of the assumptions on which the model is built to reinforce its hypothetical nature. Due care should be taken to explain to students that it is neither the model that most closely approximates reality, nor the workhorse model used in applied work. Rather, this note argues that it should be presented as a pedagogic tool that provides a useful point of departure from which other, more sophisticated models can be built.

Alternative models of the firm and responsible management

A constructive and engaging way to challenge the *laissez faire* narratives that emerge from the perfectly competitive benchmark and the potentially unsustainable management

[1] Also in *The Wealth of Nations* Smith writes, "People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in a conspiracy against the public, or in some contrivance to raise prices."

practices that they can imply, is to carefully and critically analyse the assumptions on which the model is built. The implications of relaxing each of the assumptions for the practice of responsible management can be modelled in turn, thereby forming the basis of an economics unit that engages meaningfully with PRiME's objectives. This note now turns to cataloguing some of these critiques and their implications for aspiring management professionals.

Market power in product markets: generating value?

The PRiME initiative casts the role of a firm as an instrument that generates value for society. In the perfectly competitive model, profit maximization achieves this objective only as each firm is assumed to be small in relation to the market in which it operates, and products are assumed to be homogenous. Together, these assumptions imply that individual firms are price takers and so have no market power. This complete lack of market power underpins the allocative and productive efficiency (Begg *et al*., 2014) of this theorised market structure, and thus the result that profit maximizing firms generate the most value for society. By contrast, in models that allow firms to exercise some degree of market power, a relatively straightforward diagrammatic exposition can show that profit maximization can no longer be relied upon to allocate resources efficiently (Begg *et al*., 2014). In general, when firms exercise market power, they can increase profits by raising prices through restricting output. Thus, market power implies that firms produce too little output, relative to the quantity that would maximize social welfare.

A management education that aspires to fulfil PRiME's objectives should take care to reinforce this insight. In firms that exercise a considerable degree of market power, the objective of profit maximization no longer fully aligns with that of maximizing value for society. Thus, the managers of these firms need to be prepared to make judgements that on the margin trade-off the degree of profitability of their firm against the amount of value the firm generates for society.

During the Covid-19 pandemic (which is ongoing as of the writing of this document), it is not difficult to think of markets in which restricting the supply of a good or increasing prices may reasonably be deemed undesirable. The markets for healthcare and life-saving drugs present themselves as obvious and vivid examples. But the recent shortages of more ordinary goods such as flour and toilet paper in U.K. also provide examples where firms have not raised prices out of regard for the public interest (Sanders, 2020).

Market power in labour markets: behaving responsibly?

Firms have responsibilities to their shareholders and their customers, but also to the workers they employ. In the perfectly competitive labour market assumed in introductory economics classes, there exists a going market wage at which both buyers and sellers of labour are price-takers. In this simplistic model, a binding minimum wage will reduce employment (Card & Krueger, 1994). In reality, the relationship between workers and employers is usually characterised by an asymmetry in bargaining power which favours the employer. The presence of such monopsony power can enable firms to extract rents from their employees, where these excess profits come at the cost of workers whose households are left worse off (Card & Krueger, 1994). If firms throughout the economy behave in this way, then low wages and high business profits can exacerbate inequality in a society (Lee, 1999). Without the benefit of an economics education that explicitly studies these forces, even well-intentioned managers wishing to protect their most vulnerable workers from unemployment may act out of a misguided hostility to minimum wage legislation.

A further nuance of this model is that the asymmetry in market power between a firm and its employees is likely to be most pronounced among unskilled workers at the bottom of the wage distribution as these workers are themselves least likely to exercise market power (Card & Kreuger, 1994). For these workers, a countervailing force to the asymmetry in bargaining power, such as a union, may help improve wages and working conditions and thereby support responsible business practice.

To ensure that future business leaders are equipped to make informed decisions regarding their workers, an economics curriculum motivated by PRiME should include the basic insights of the monopsony model. Doing so will enable the next generation of management professionals to adopt better hiring practices and to understand the important role that minimum wage legislation and unions can play in protecting their vulnerable workers.

Externalities and the legitimacy of regulation

A key stated objective of the UN's PRiME initiative is to promote sustainability. One of the ways in which the perfectly competitive benchmark does a disservice to sustainability is by assuming away the possibility of externalities. As can be simply illustrated in a demand and supply diagram, the social welfare maximizing property of the perfectly competitive benchmark depends crucially on the assumption that there are no externalities (Begg *et al*., 2014). The existence of externalities – effects of a transaction that do not fall on the parties engaging in the transaction, that are not captured by the price mechanism – will again place demands on tomorrow's decision makers that an overly simplistic economics education will fail to prepare them for. Managers of firms that produce substantive negative externalities who strive to generate sustainable value for society will need to make difficult choices that trade-off firm profits against the harm that is done to society in the pursuit of these profits.

Proponents of a *laissez faire* system point to forces that may effectively align the incentives of firms with those of society more broadly, even in the presence of externalities (Hemphill, 1992). A firm that causes harm to the environment may suffer reputational damage which in turn affects profits, whereas a firm that proactively utilises more sustainable methods of production may be more attractive to customers. In other words, an informed and socially engaged consumer base may provide firms with incentives to regulate themselves, thus allowing managers to focus simply on profit maximation.

This line of reasoning itself depends on some strong assumptions that are unlikely to be valid in the real world. First, it may be costly for consumers to gather reliable information on the nature and extent of damages inflicted on the environment by firms. Second, even if consumers have the appropriate information, there is no mechanism that suggests that the extent to which they penalize polluting firms or reward sustainable ones will be proportionate to the extent of the externality. Indeed, the 2015 Volkswagen emissions scandal (Hotten, 2015 provides a useful summary), where the company was found to have installed devices that were designed to cheat emissions tests on entire ranges of vehicles, illustrates that in practice firms may go to considerable lengths to actively mislead the public about the extent of the damage they are causing. It may also be argued that the long-term penalty exacted by market forces on Volkswagen for a relatively severe breach of consumer's trust (cheating vehicles produced emissions levels 40 times those permitted by law) were relatively short lived, with share prices first returning to the pre-scandal levels in November 2017, a little over two years since the news of emissions cheating broke (Bryant, 2017).

The presence of externalities thus implies an important role for the state to play in imposing and maintaining regulatory standards. A simplistic economics curriculum that overemphasises *laissez faire* narratives will encourage business leaders to argue that such standards are 'burdensome regulations' which 'get in the way of business', phrases that have been common refrains among business lobby groups, with those that advocated in favour of Brexit providing a recent example. An economics educator designing a curriculum in line with PRiME should take care to invert this narrative and celebrate appropriate regulation as enabling force towards sustainable businesses.

Public goods and the legitimacy of taxation

While it is certainly true that market forces have delivered incredible prosperity to the modern world, an economics curriculum consistent with PRiME should recognise that they have not done so in isolation. The market system relies on the state to provide functioning legal and regulatory institutions, as alluded to above, but also infrastructure such as ports, roads and highways, as well as essential inputs to the human capital employed by firms such as healthcare and schooling. Therefore, sustainable business depends on a sustainable state apparatus, which in turn must be funded by a sustainable level of taxation.

This reality – that markets can only function in the presence of a host of goods and services provided by the state and funded by taxation – is formally circumvented in the perfectly competitive benchmark by assuming that there are no public goods or externalities (Begg *et al*., 2014). Indeed, the logic of the perfectly competitive benchmark goes further, and concludes that taxes induce an 'excess burden' and a 'deadweight welfare loss' on society (Begg *et al*., 2014). While an economics curriculum should of course acknowledge the distortions induced by taxes, a curriculum that supports PRiME's objectives must go further and explain the value added by strong and appropriately funded government agencies, both to society in general and to the business climate in particular. Indeed, the current understanding of economic growth processes suggests that the quality of a country's institutions is the most important determinant of long-term growth and prosperity (Acemoglu & Robinson, 2012).

These arguments are not just theoretical curiosities, but the subject of heated contemporary public debate that a responsible economics curriculum would do well to engage with. A major battle line in the recent U.K. election was the rate at which corporations would be obliged to pay taxes on their profits (Adam, 2019 provides an informative summary). A number of cases where large corporations such as Amazon and Apple have been able to legally reduce their tax bills in the U.S. and U.K. have also generated considerable media scrutiny (for example Sherman, 2019). While it is certainly advantageous for firms in the short run to minimize their tax burdens, such strategies are likely to prove neither responsible nor sustainable. In the long run, an impoverished state may struggle to provide the quality public services that businesses depend on. The U.K. government's Coronavirus Job Retention Scheme provides a vivid contemporary example of the immense value that businesses can reap from strong and properly funded public initiatives (Dias *et al*., 2020).

Conclusion

The UN-backed PRiME initiative calls for businesses to interact with the societies in ethical and sustainable ways. The narratives that emerge from simplistic economic models that are often encountered in introductory economics modules on the typical management curriculum can be at odds with these objectives and can leave aspiring practitioners of responsible management unprepared for the difficult trade-offs they are likely to face in their careers. This note has argued that a careful critique of each of the assumptions that underpin these simplistic narratives and an exposition of the alternative models that arise from each critique can provide a basis for an engaging economics curriculum that will better equip the next generation of managers to make informed decisions between the extent of firm profits and other considerations such as the welfare of customers, the wages of workers, and making a just contribution to the functions of the state that enable business to flourish. Such an economics curriculum will help business schools to deliver a management education that fulfils the ambitious objectives envisioned by PRiME.

Data availability

No data are associated with this article.

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